NPL Resolution

REZA BAQIR

Mission Chief
International Monetary Fund

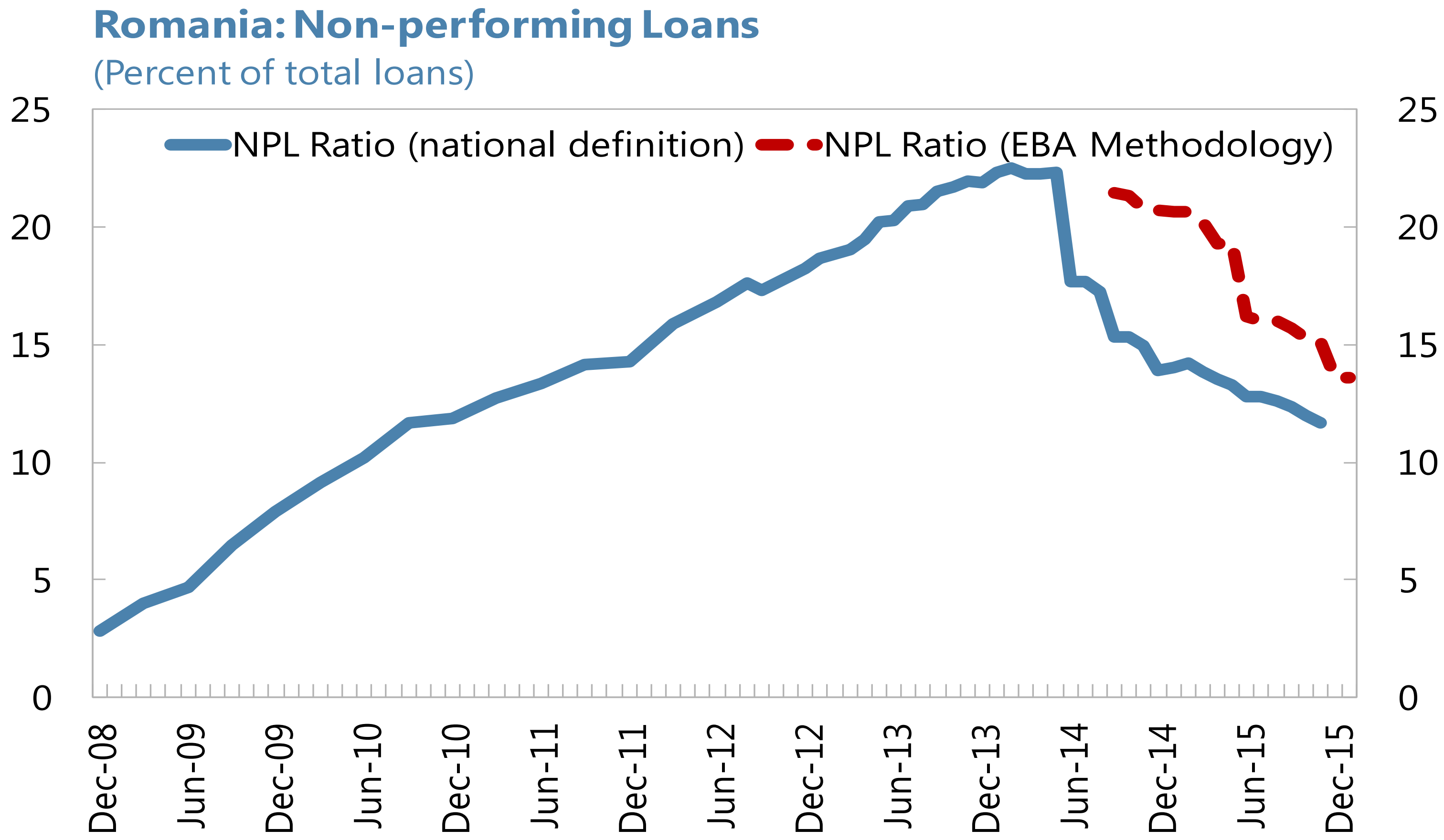
Bucharest, 15th June 2016

Outline

- Context and recent trends in NPLs
- Why NPLs need to be resolved
- What more needs to be done

This presentation draws heavily on the IMF Staff Discussion Note (2015), *A Strategy for Resolving Europe's Problem Loans*, available at www.imf.org.

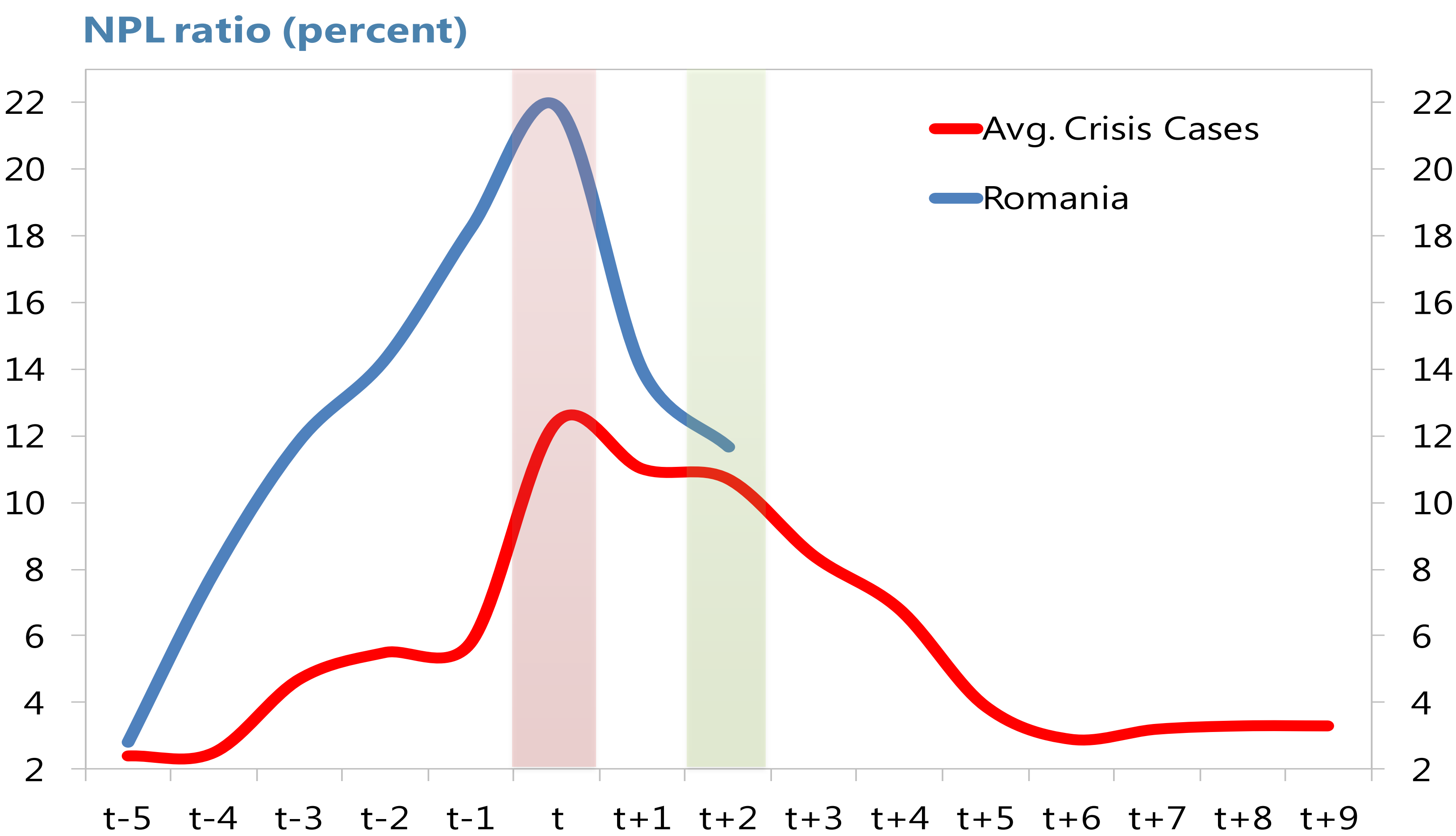
Context



Note: In December 2015, NBR moved from a national definition to an EBA methodology-based definition of NPLs. Sources: NBR and IMF staff calculations.

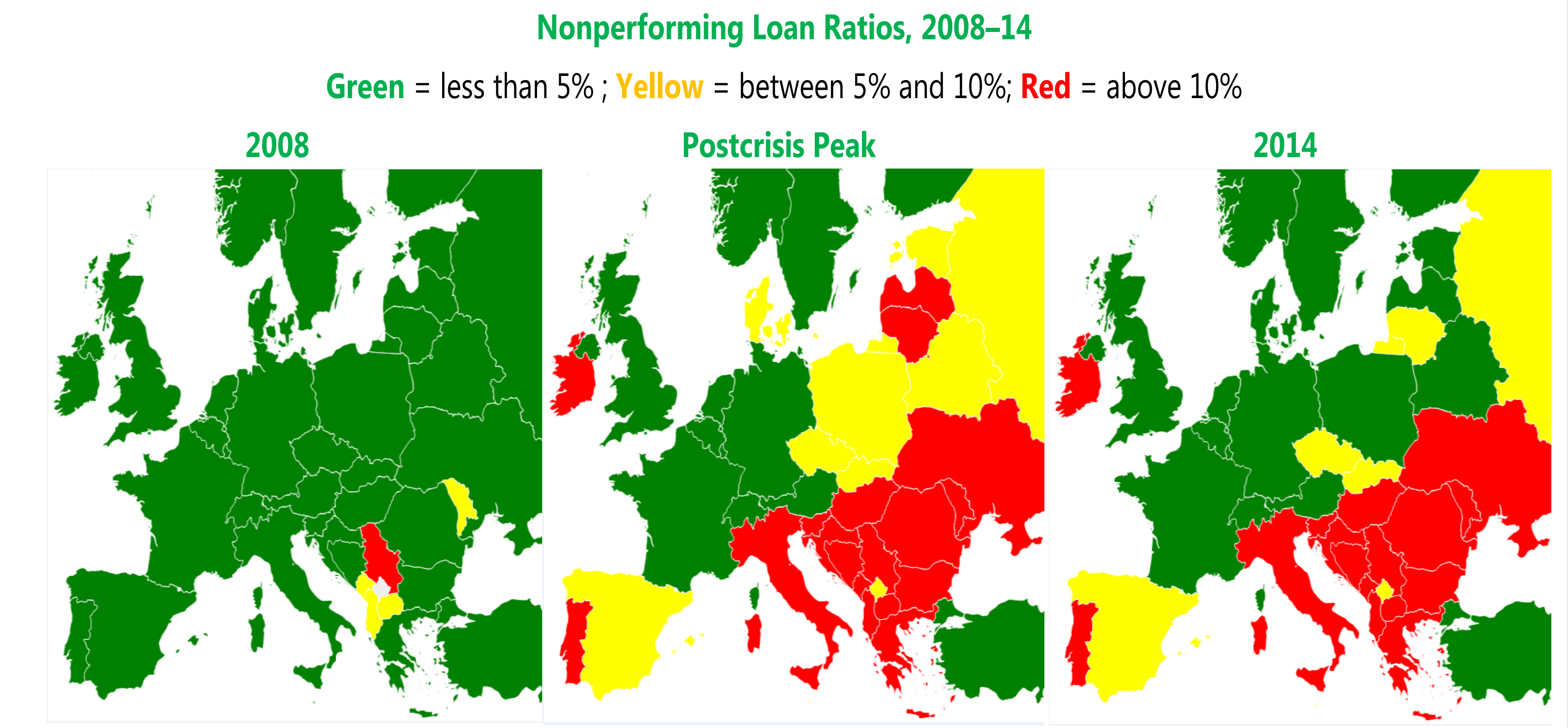
NPLs: Romania compared to crisis cases

4



Sources: EBRD; IMF. Note: t = 0 corresponds to the peak NPL year. For Romania, it is 2013.

NPL developments

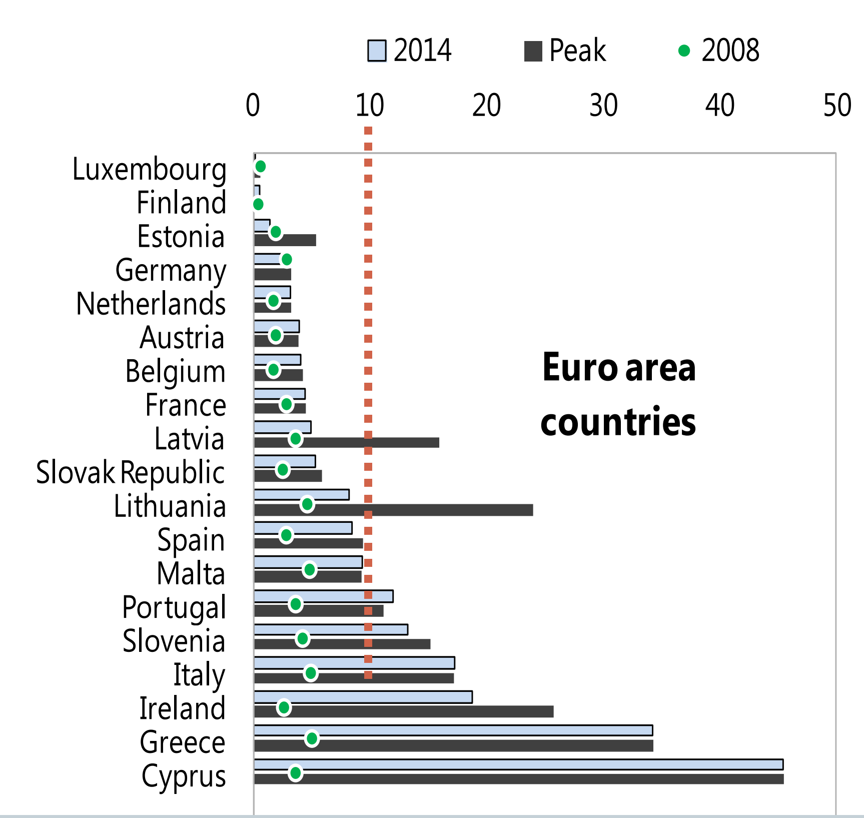


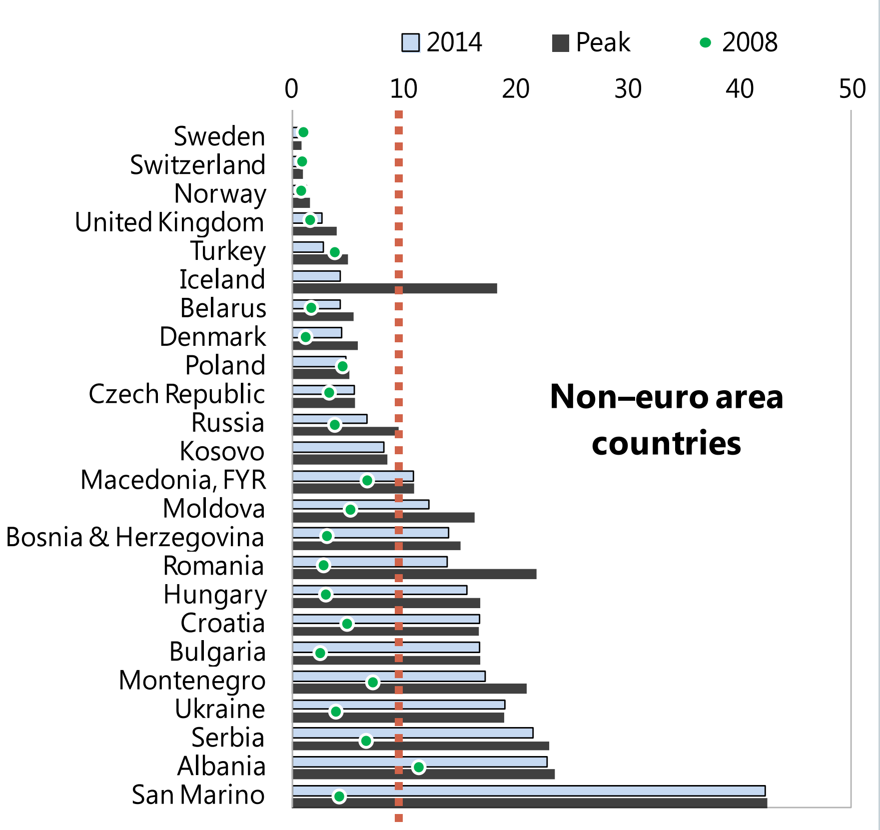
Source: [IMF (2015), *A Strategy for Resolving Europe's Problem Loans*]
Note: The FSIs are computed using consolidated bank data and therefore do not reflect only domestic NPLs. For example, in Spain the postcrisis peak and 2014 figures based on domestic data only are above 10 percent (13.5 percent and 12.5 percent, respectively).

NPLs: Euro Area vs. Non-Euro Area Countries

6

***Europe*: Gross NPLs, 2008-2014** (*in percent of total loans*)





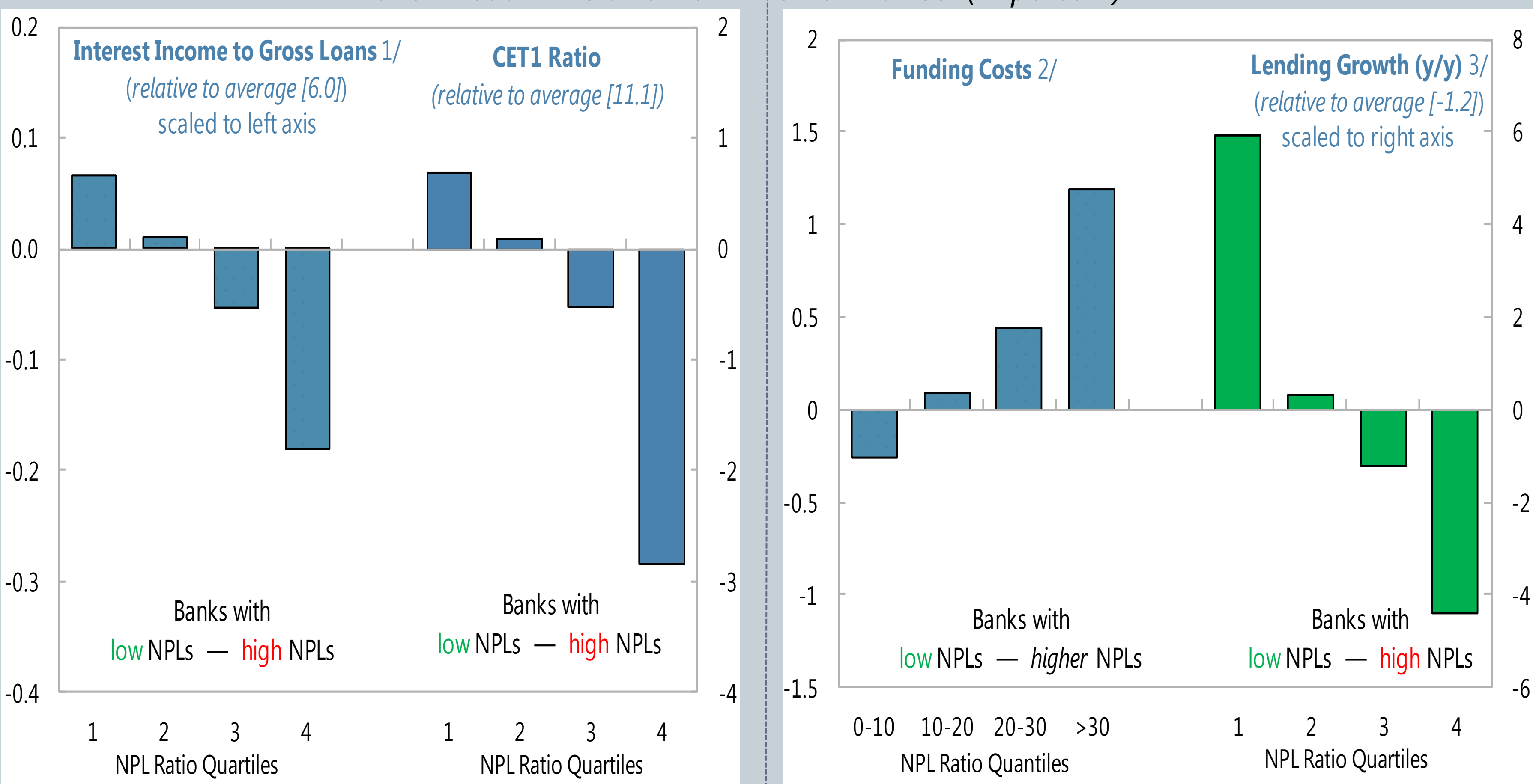
Sources: [IMF (2015), *A Strategy for Resolving Europe's Problem Loans*]; FSIs; country authorities; and IMF staff calculations.
Note: EA average NPL ratio = 10.4%; non-EA average NPL ratio = 11.2% as of end-2014

Outline

- Context and recent trends in NPLs
- **Why NPLs need to be resolved**
- What more needs to be done

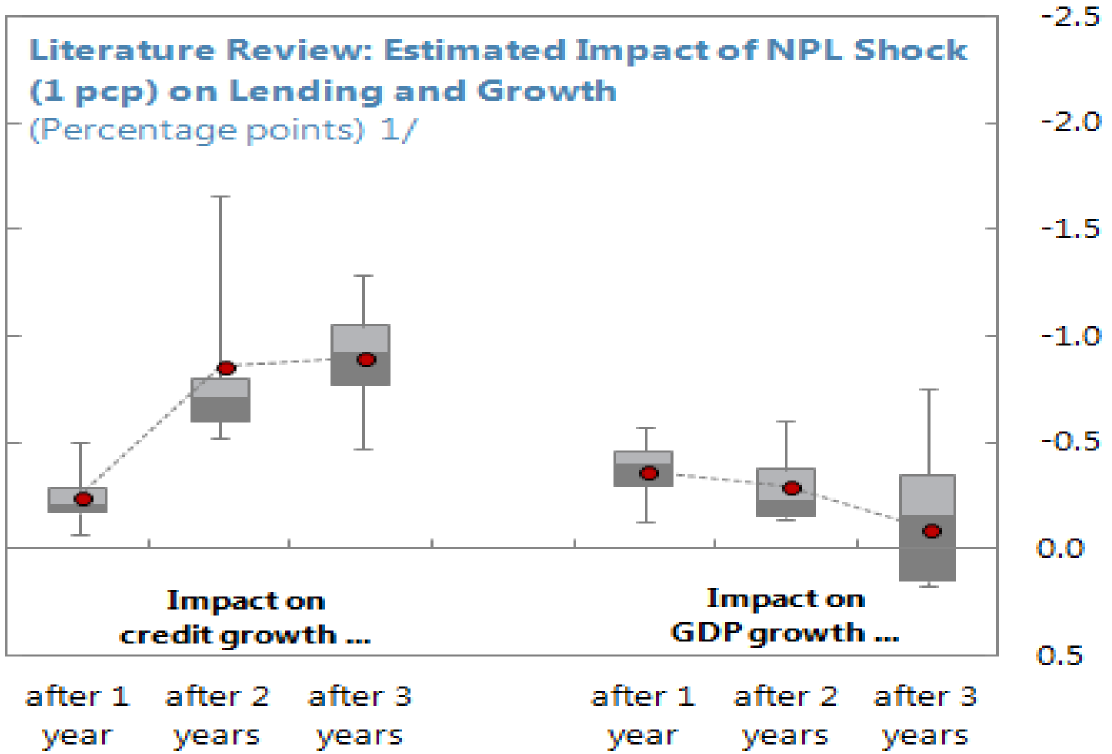
Banks with higher NPLs are less profitable, have lower capacity to generate capital, have higher funding costs and lend less

Euro Area: NPLs and Bank Performance *(in percent)*



Source: [IMF (2015), *A Strategy for Resolving Europe's Problem Loans*]

NPLs: Implications for lending and growth



Sources: Dovern and others (2010), Espinoza and Prasad (2010), Nkusu (2011), De Bock and Demyanets (2012), Klein (2013), Bending and others (2014), and IMF staff calculations.
Notes: Positive (negative) values indicate a negative (positive) change in lending/growth. 1/ Boxplots include the mean (red dot), the 25th and 75th percentiles (grey box, with the change of shade indicating the median), and the maximum and minimum (whiskers).

Source: IMF (2015), *A Strategy for Resolving Europe's Problem Loans*

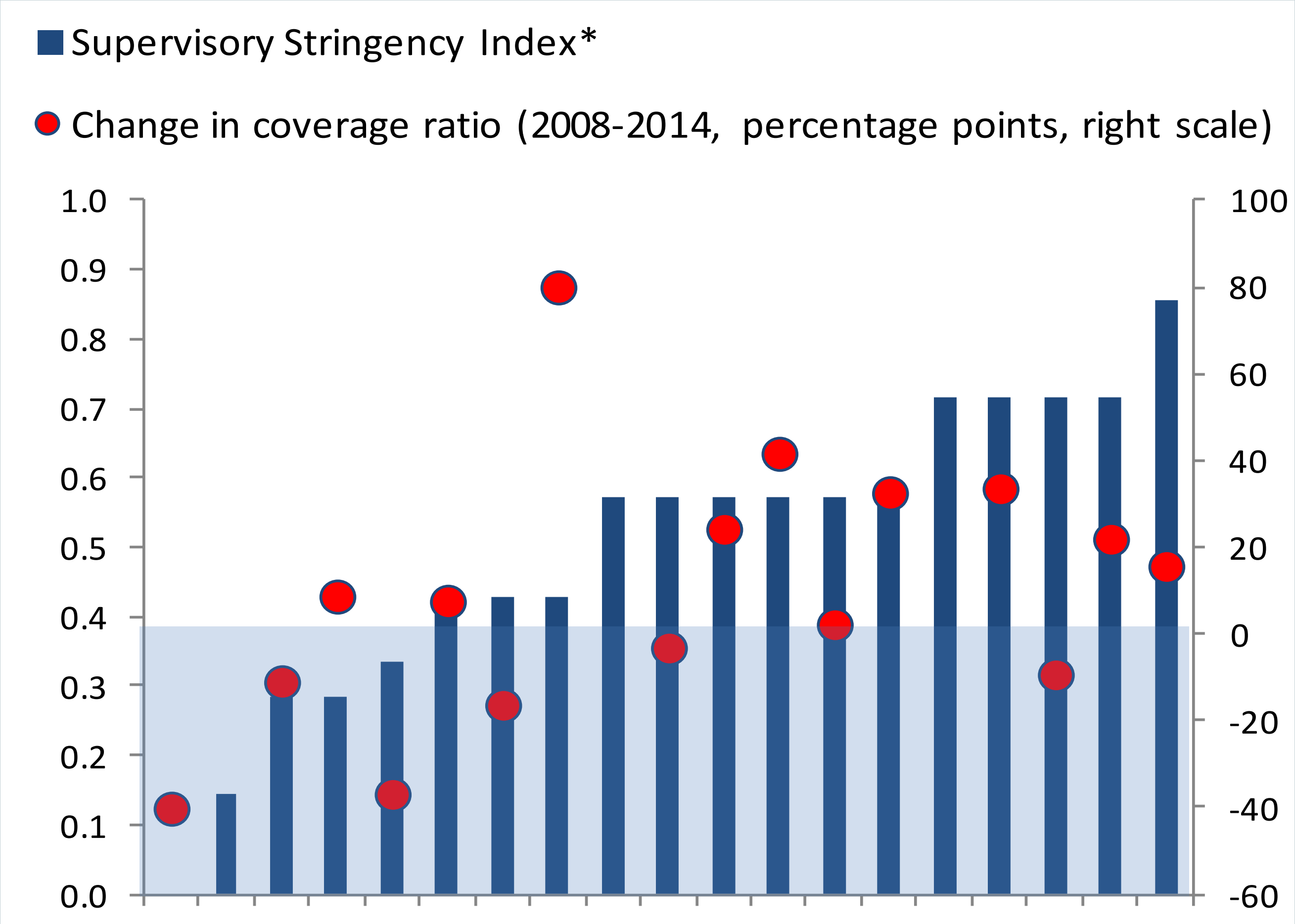
Outline

- Context and recent trends in NPLs
- Why NPLs need to be resolved
- **What more needs to be done**

Resolution of NPLs: A Three-Pillar Strategy

- **Enhanced supervision**
  - International experience: swift loss recognition (Sweden, Korea).
- **Reforming debt enforcement and insolvency regimes**
  - International experience: (i) *liquidation* of non-viable debtors (Ireland, Indonesia, Thailand, Turkey, Japan, and Korea); (ii) *rehabilitation* of viable debtors through insolvency procedures/out-of-court workout
- **Developing distressed debt markets**
  - International experience: AMCs used for NPL disposal/corporate restructuring (Sweden, Indonesia, Malaysia, Korea, and Thailand; Spain (SAREB) and Ireland (NAMA))

Supervisory Stringency and Coverage Ratios (2008-14)



Source: [IMF (2015), *A Strategy for Resolving Europe's Problem Loans*]

Tighten regulation and accounting standards

More realistic accounting standards

Specific guidance on provisions.

Consistent, time-bound write-off requirements.

Conservative valuation of collateral.

Non-accrual principle past set delinquency.

Prudential measures

Time limits / write-down targets.

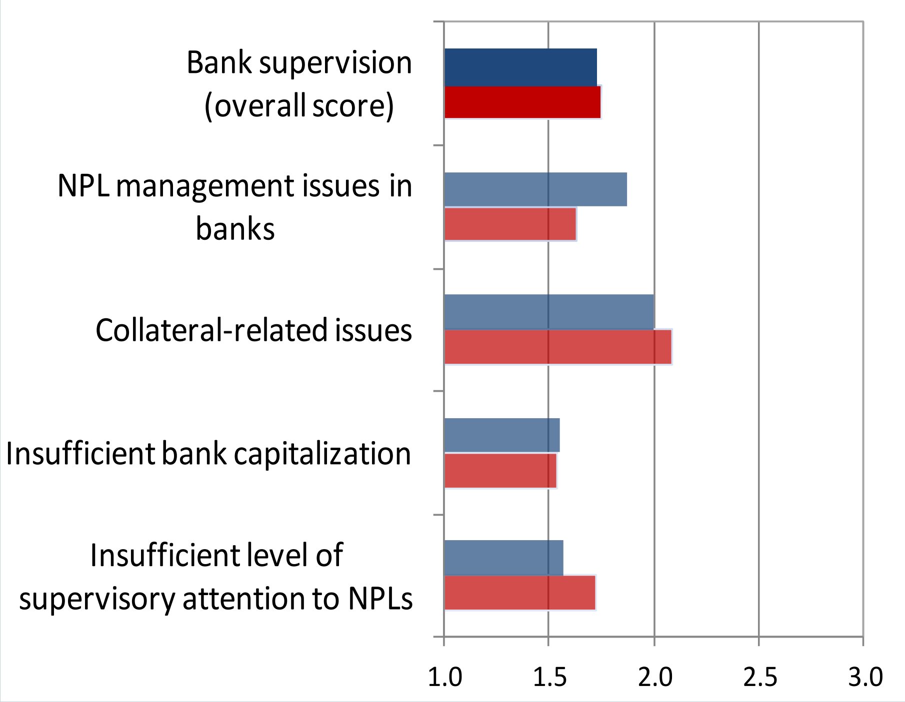
Higher capital charges on long-held NPLs.

Triage approach. Standardized criteria for separating non-viable firms (liquidation) from viable firms (restructuring loans) (e.g., Korea).

IMF Survey

Average Scores on Obstacles to NPL Resolution

(by sub-category, euro area [blue] vs. non-euro area [red])



Note: Degree of concern: "3" = high, "2" = medium, and "1" = no concern

Source: IMF (2015), *A Strategy for Resolving Europe's Problem Loans*

Enhanced supervision: Romanian experience

NBR actions to write off fully provisioned NPLs

- Fully provision loans overdue 360 days; high risk weight otherwise.
- Increase coverage to 90 percent for all exposures to insolvent borrowers
- Granular data requirement on NPLs
- Periodically use external professional appraisers for collateral valuations
- Allow buyers to deduct provisions from the gross value of the purchased loans for tax base

Reform debt enforcement and insolvency regimes

Foreclosure/debt enforcement

Less costly and protracted procedures implies more effective and predictable asset recovery.

Limit appeals; short preclusive deadlines.

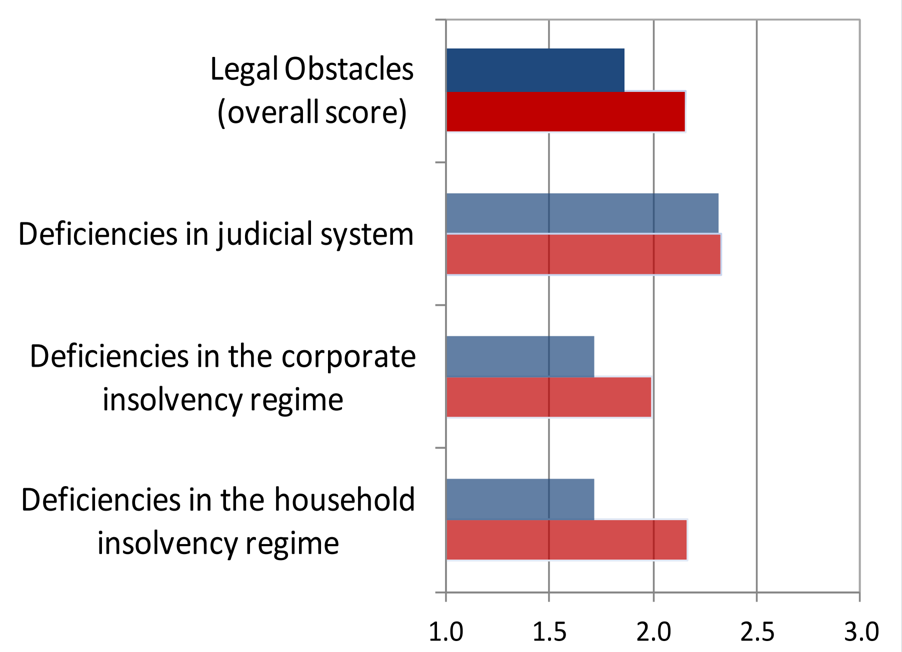
Institutional framework

Efficiency of institutional framework can be even more important than formal laws.

Specialized judges and insolvency administrators/ performance-based fee structure (metric: rapid return to productive value of assets).

IMF Survey

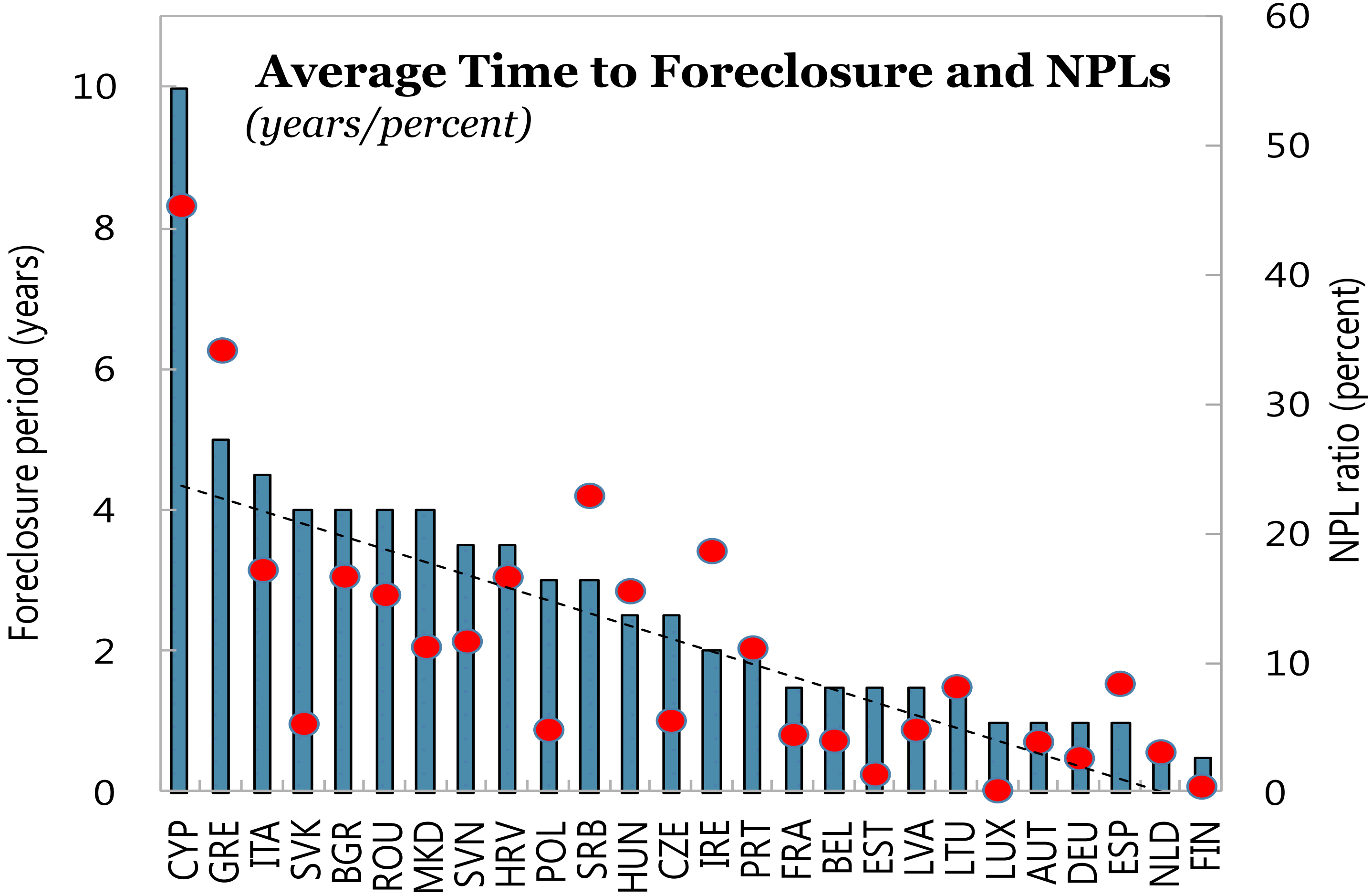
Average Scores on Obstacles to NPL Resolution
(by sub-category, euro area [blue] vs. non-euro area [red])



Note: Degree of concern: “3” = high, “2” = medium, and “1” = no concern

Source: [IMF (2015), *A Strategy for Resolving Europe’s Problem Loans*]

An example of legal obstacles



Source: [IMF (2015), *A Strategy for Resolving Europe's Problem Loans*]

16

Reform debt enforcement and insolvency regimes: Romanian context

Corporate

- Corporate Insolvency Law; but limited experience with its implementation
- Establishing specialized courts / training specialized judges: progress but slow. More high quality insolvency administrators are needed.

Household

- Personal insolvency framework yet to become functional

Kick-start a market for distressed debt

- **Reduce barriers to entry**
  - Licensing, legal impediments to bilateral sales and non-bank/foreign ownership, compliance cost, tax considerations, uncertainty about (duration of) asset recovery
- **Improve access to (consistent) debtor information**
  - Asset registers, credit bureaus.
- **Encourage a wide range of risk-sharing techniques**
  - <u>Structured finance</u> e.g., NPL securitization.
  - <u>Asset Management Companies (AMCs)</u> (private/public) …
    - *Economies of scale* (asset recovery, marketability, investor interest)
    - *Bargaining power* (size and centralization of collateral)
    - *Specialization* enables bank to focus on lending
- **Combine with robust supervision and insolvency reforms.**

An AMC would need to be compatible with EU state aid rules

In some cases, **public support** may be needed to overcome the pricing gap…

- **EU state-aid rules**
  - Any transfer of public resources defined as state-aid.
  - Requires bail-in of creditors under BRRD (with systemic exemptions).
- **A state-aid compatible AMC model:**
  - Assets sales at market price (or using accepted pricing methodology where no market exists). Therefore no transfer of public resources.
  - Minority public stake
  - Voluntary participation
  - Clear mandate / Transparent governance

Thank you